RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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December 20, 2000 **LETTER 1311**

MY POSITION: Men and women, the fund and pension managers who handle millions and even billions of dollars of "other people's money," they almost never disclose their own investment positions. I wish they would – it would be very interesting and highly instructive.

Personally, I have no problem disclosing my own thoughts, my own strategy and my own investment position. I do it in the Letters every few months or so.

First let me tell you how I think. I think a great bull market has topped out. I believe this based on my studies of Dow Theory and my experience with the markets over a period of 50 years.

To make it very simple, the basis of Dow Theory (although few people are aware of it) concerns itself with **VALUES**. In a great bull market (and we've been through one) stock prices rise to extremes in values. In fact, the late bull market has produced extremes in valuations that have never been seen before. They were absolutely unprecedented.

In previous bull markets the tops were generally recognized when the Dow climbed to the point where it provided a yield of 3% and where price earnings ratios rose to around 18 to 20.

December 1 DJIA 10373.84; PTI 5168; A-D Ratio –7.57
December 8, DJIA 10697.08; PTI 5179; A-D Ratio –6.95
December 15, DJIA 10434.96; PTI 5181; A-D Ratio – 7.19
***Dow Times Book Value: +6.37**
***Percentage of Undervalued Blue-chips: 14%**
***Gold 34-day MA: 272.5**
***Dow yield: 19.8** ***Dow P/E: 1.73**

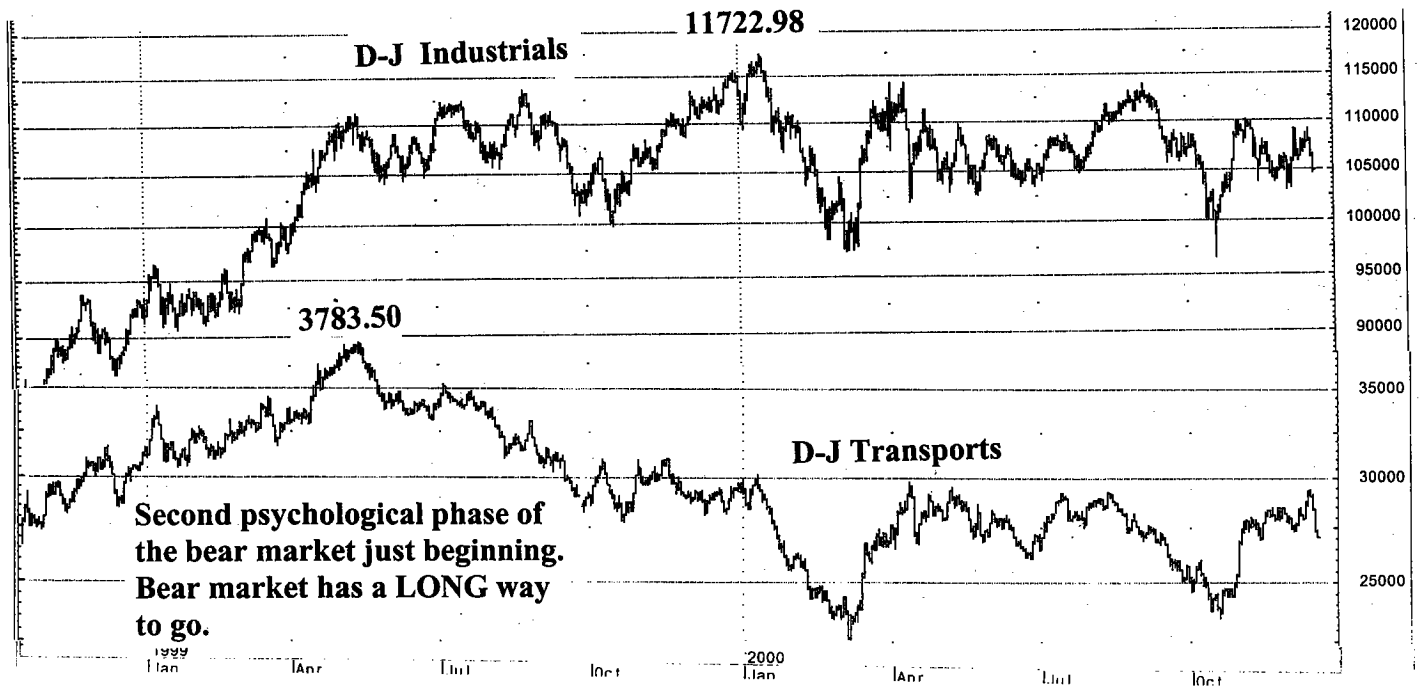
In this bull market we've seen the yield on the Dow sink below 2% while price/earnings rose to well above 20 (the S&P P/Es rose to 30). This was clearly third phase bull market action.

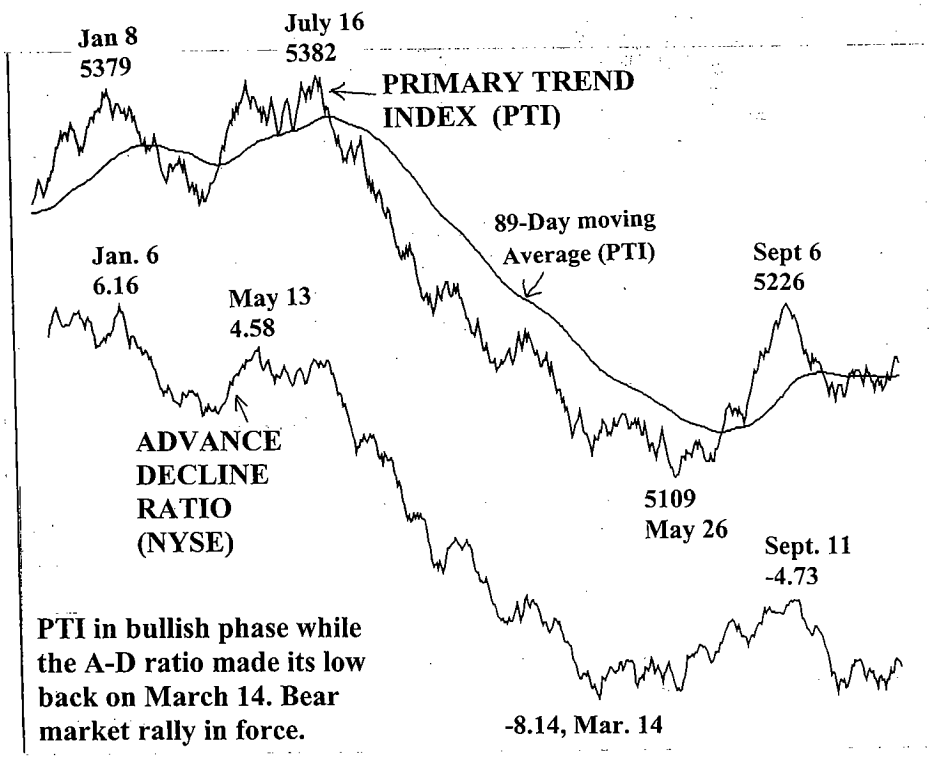
Then in September 1999, we received a Dow Theory bear signal and in February 2000 we got a re-confirmation of that bear signal. I took this action to represent the turn of the tide – the death knell for the bull market.

Great bull markets tend to give way to great bear markets. And that's what I believe lies ahead. So far we've seen a 50% bear market in the ridiculously overpriced Nasdaq, but the Dow and the S&P have given up their huge gains only grudgingly.

So far, many individual stocks have been pulverized, but in a great bear market, the major averages tend to lose at least 50% of the gains produced by the previous bull market.

To put it bluntly, we're hardly there yet.





If I'm correct, if my interpretation of the Dow Theory proves correct, we are in the process of the great (usually tortuous and deceptive) wave from a bull market top to a bear market bottom.

At the bottom of a bear market we see stocks selling at what we call "great values." The time-honored measurement of great values has been the Dow. Great values, in the past, has meant the Dow selling at around ten times earnings while yielding around 6% or better.

Could this possibly happen again? I think it could. How could it happen? I obviously don't know exactly how it will happen. I don't know how the path down will proceed. But I do think I'll be able to IDENTIFY the bottom. In this business, it makes far more sense to **identify than to predict**. At any rate, consider the following.

In late-1974, I called the end of the worst bear market to occur since the 1930s. At the time all I knew was that the market was telling me that the worst was over. Happily I was able to IDENTIFY the bottom. I had no idea how we were going to get to the bottom, I didn't know what set of circumstances would lead to the bottom.

But I knew a bottom when I saw it. Stocks in late-1974 were selling at great values (the pattern of the Averages at that time merely confirmed that the bottom was indeed there).

But if you had said in 1974, "Russell, by the year 2000 the Dow will be selling at over 11000 and many stocks will be selling at 50, 75, 100 times earnings and more – with no dividends" – I would have said that you were out of your mind. That simply can't happen.

Today I'm saying that before this bear market is over, we could see a Dow selling at 10 or 12 times earnings and yielding around 6%.

"What could cause anything like that?" you ask. And my answer is -- I could give you a lot of theories and "what ifs" and "if this happens" but the true answer is that I really don't know.

OK, let's play "Russell's a Dow Theory crazy -- but let's also pretend that he's correct." In other words, let's just suppose what I have written above makes sense and actually comes to pass.

"Russell, if you believe what you wrote above, what are you personally doing about it?"

What I've done, and I've told subscribers this before, is to move into the highest-grade muni bonds. I intend to hold these bonds and compound the interest they throw off until the bear market hits what I think is the bottom. At that point I'll probably move into the best-grade, dividend-paying common stocks.

Here's a concept that is interesting and counter-intuitive. Once you have your position in high-grade bonds, you want to compound the tax-free money those bonds throw off. When bonds decline in price their yield rises. So in compounding you should view the investing process as simply **buying more income.**

Consequently, and here's the counter-intuitive part, you really want the price of bonds to go down. The lower the price of the bonds you are buying, the more income you are taking in.

Of course, this is all predicated on the fact that you are buying and holding top-grade bonds. These are bonds that will mature at par or a price of 1000. If you continue to compound, in time, the ever-compounding income you receive will dwarf the original price of the bonds that you bought.

"All right, Russell, and suppose you are wrong about the stock market? Suppose the 'old bull market' revives or we start a new bull market from these levels?"

I don't think that's going to happen, but if it does -- then I'll still be sitting with a lot of muni bonds, I'll continue to compound, and I'll just wait until stocks finally sink to the point where they represent great values. That may never happen in my lifetime, but you know something, if it didn't happen I would hardly consider it a problem.

MORE ON JUST INVESTING: The three hardest things to get over to subscribers (and investors in general) are:

(1) The importance of a long-term policy of buying values in the market.

(2) The importance of believing that there IS a primary trend and then investing with the primary trend.

(3) The importance of compounding your wealth.

I wrote quite a bit about number 1 and 3 in the "Rich man, Poor man" piece on my web site.

Probably the single hardest thing to get over to investors is that there really is a primary trend. There are two reasons for this. The first is that the market never goes straight up (bull market) or straight down (bear market). The road from the bottom of a bear market to the peak of a bull market is always extremely difficult to follow. How many people do you know who bought stocks in 1980 or 1982 and held them through all the trials and tribulations right to the top? Do you know anyone who did?

The second reason why investors can't or won't believe in the primary trend is that they can't envision CHANGE. **Yet the surest thing in the markets is change.** Dow wrote about it, all the Dow Theorists have written about it, all history illustrates it. But people (including most stock market analysts) can't seem to fathom the concept of change.

The biggest obstacle in recognizing change is probably the expression, "This time it's different." In other words, whereas all other bull markets gave way to bear markets, this time it's different. And whereas all bear markets have given way to bull markets, well, it won't happen in this instance because this time it's different.

We're now in a bear market. How many people, I wonder, will stay out of the market, stay in cash or notes or bonds, and ride this bear market, this extremely deceptive bear market, all the way to its ultimate bottom? Not many, I assure you. It takes discipline, patience, and a conviction that we are, indeed, in a bear market, and that the best procedure is to stay out, stay safe, and stay with the program.

I know that dividends are now ignored by most advisors. Go through an issue of S&P's *Outlook* or a *Value Line* mailing. Almost all the stocks they recommend are devoid of dividends. Their recommended stocks don't pay out a nickel. Buy a stock with no dividend in a bear market and you'll end up with a stock that's lower-priced than when you bought it, and a stock that has never paid you a cent.

Dividends allow you to build up cash. Dividends allow you to participate in the greatest and surest road to wealth – **compounding.**

People think Warren Buffett is a genius, and he might well be. But without ever saying so, Buffett is now in the business of compounding. As Buffett's various businesses throw off cash, what he does is buy more businesses. See's candy, Dairy Queen, a furniture store, a newspaper, a building plaster company, they're all good businesses, and they all throw off cash. With that cash Buffett buys more companies. Buffett is in the business of compounding companies, although I don't see anyone explaining what he does in that way.

Note that all these good little businesses that Buffett buys **throw off cash.** They're profitable most of the time. But note that Buffett doesn't pay any dividends on Berkshire Hathaway. He's too smart for that. He compounds the cash and buys businesses, but he doesn't pay his stockholders a cent. Cute, huh?

So above are some of my ideas and suggestions on investing. They've worked for me over the years. And they might very well work for you, my beloved, faithful subscribers.

INVESTMENT POSITION: The bear remains in the box. And it shouldn't be hard to figure out my investment position. Let me put it this way. In a bull market the problem is to take advantage of generally rising prices. Conversely, in a bear market the idea is simple enough – the idea is to try to avoid losses.

I'm proceeding on the thesis that this bear market is going to be hard on business. If this proves correct, then (1) investors are going to foresake the concept of growth and slowly come to the thesis that income is going to become more important than growth.

(2) As the economy slows and as the bear market moves on, stockholders will find themselves holding stocks that are declining and stocks that throw off no income. Since the economy will be slowing, there will be a rising desire for income. Families will find that they need income to pay off their debt.

(3) The best place to obtain income in a bear market is in high-grade bonds. This is particulary true in this bear market because the average yield on stocks is a ridiculous 1.5% and in the case of a huge number of stocks there are no dividends at all. Never have I seen so many stocks that are dividend-less. This is going to be a huge problem as the bear market rolls along.

NOTES & QUOTES: I said that from time to time I'm going to include some news stories as they originally appeared in the newspapers. So here we go -

"Dec. 24, 1913: Federal Reserve Begins; 213 Banks Join. Some 213 of the nation's banks have applied for membership in the new Federal Reserve System that was created under a law signed yesterday by President Wilson. The new federal banking system will provide a means whereby banking notes and credits will automatically expand in times of business prosperity and deflate as the volume of business declines.

"By creating 12 Federal Reserve banks to serve as depositories for member banks, the United States will now have a central authority to serve banking interests without having a single large institution, such as the Bank of England. In signing the bill into law, President Wilson used several gold pens, and he said jokingly, 'I'm drawing on the gold reserve.'"

* *

Speaking of the Fed, here's a bit of news. A few weeks ago Congress voted to give Alan Greenspan an 11% boost in salary. The Green man was receiving $141,300. His new salary will be $157,000. With perks, naturally. The bill also increased the Fed's seven governors' salaries from $132,000 to $141,300 - with perks, naturally.

* *

Real Estate: Real estate prices on both coasts have reached "unreal" levels. In *NYC* prices have run absolutely wild. The old St. Moritz hotel on Central Park South has been sold and "done over." The top 12 floors of the 35-story hotel are reserved and will be a joint project by the Ritz and Ian Schrager. These floors will consist of 11 giant units ranging from 5,000 to 10,000 sq. ft. Prices will be $17 million for a low floor apartment to $39.5 million for the largest. Among one of the projected buyers, Larry Ellison of Oracle.

Other East Side brownstones are going for up to $20 million (these are buildings that could have been bought for $500,000 back in 1974).

OK, this is from a full-page ad in last week's *LA Times*. "The world's most elegant, from $ 10,000 per month. For those seeking the ultimate height of luxury, there is only one address. Rising 20 stories above Wilshire, the Sterling International Towers". . . on and on ... Spectacular one, two, three and four bedroom extra large condominium type apartment residences are priced from $10,000 to $30,000 a month. **Russell comment:** If any subscribers are interested, call them: (310) 275 2992.

* *

New York:-- A full-page story in a recent *NY Times* (Nov. 26) starts, "The State of Life in the City: Packed Like Sardines." Ah yes, how I remember the subway coming home from school. Cattle have never been packed so tight. It was eerie, it was Manhattan.

I left my home town of New York in 1961. That was the last year that you could park your car in midtown Manhattan without getting a ticket or without someone breaking into it. Also, I felt the crowds were beginning to get a bit too thick. Just too many people - and that was back in 1961.

Today the situation is a LOT worse. The *Times* writes about two people who "headed to a fashionable downtown restaurant with a reservation on an unfashionable Tuesday at 8PM - made after they gave up trying to go out on weekends because every restaurant, movie or jazz club always seemed to be booked. When they arrived, the restaurant was packed and their table was in use. They were offered drinks on the house, but bodies were three-deep at the bar. They were finally seated 70 minutes late."

The article continues, "Chris Lopes, 24, an electrician, says, 'I hate it, I hate it, I just hate it. I don't like breathing other people's breath, I like kissing my wife when I get home, not the guy sitting next to me on the trains at 5:30 in the morning. It's disgusting."

"A computer operator who commutes says 'I just literally want to scream, 'Don't touch me, don't touch me! Everybody, just let me sit or stand in enough human space not to be mauled for an hour.' All joking aside, part of the reason why the city is so hostile is because you're treated like an animal twice a day'."

Russell Comment: The only way to live decently in New York is to have almost unlimited money and not have to be anyplace at any special time. In other words, live like Jerry Seinfeld who just spent $12 million for an apartment in the City and $35 million for a 12-acre estate in South Hampton.

Actually, all the good spots (weather-wise) and all the exciting spots (culturally-wise) in the nation are becoming crowded. And that, by the way, includes La Jolla. The problem - the never-ending population boom.

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What's this human genome area of biotech all about? Basically, it's a gamble that these genome outfits (that are now selling at sky-high prices, considering that most of them have no income) will come up with something saleable in the way of drugs or some other way of treating diseases.

Most of the genome companies have been financed by such outfits as Schering-Plough or SmithKline Beecham. Many have racked up huge debt with little or no marketable anything to show for their debt.

Personally, I'm all for the genome research. Who knows, they may come up with something that will turn me into a

teen-ager again – or maybe a drug that will allow me to live to be 200. With it all, however, they'll have to do their research with somebody else's money. It's too speculative for my meager savings.

* *

I never succumbed to the lure of Las Vegas but an awful lot of people go there. Last year, Vegas extracted $25 billion from its visitors. The *Financial Times* describes Vegas as follows: "The reality, of course, is that gambling is hardly glamorous. Behind the market machine that is Las Vegas – the gambling mecca of the world – lies an industry fueled by middle-aged mothers and stocky senior citizens who methodically pump coins into slot machines in a venue which usually resembles nothing so much as a middle-market motel.

Slot machines account for most of the take, but the high-rollers (people who bet $100,000 or more during a visit) see the slots or "one-armed bandits" as sucker bait. The high-rollers prefer the table games such as poker, blackjack and baccarat, which require some element of skill. The so-called "whales" bet $1 million or more during a single visit. The whales like baccarat, which has a slight house advantage of 1.24%.

Analysts predict a slowdown at the casinos, mainly because of saturation. The big US casinos, MGM and Harrah's, have already been downgraded as a result of the projected drop. Excluding baccarat, casinos on the strip saw their revenues fall 3.2% in September.

* *

This from the *Palm Beach Post* (the Florida Medical Assoc. has tried to shut down chelation). Headline: "Medical officials face tough crowd over chelation. Fort Lauderdale – Dozens of patients whoop-whooped, clapped hands and took turns taking verbal jabs, Thursday, at a state advisory committee, in the end persuading it not to clamp down on a controversial treatment for the leading cause of death.

"Heart patients told the room of about 60 how they defied their cardiologists and fell in love with chelation therapy, how their chest pains vanished without prescription drugs, and how they avoided expensive bypass surgery.

"In chelation therapy, a synthetic amino acid called ethylene diamine tetracedic acid is dripped into the blood stream slowly. Metals bond with the EDTA and are flushed out of the body in urine. Patients typically undergo the three-hour treatments about 30 times during several months."

Russell comment. In Florida, intelligence has triumphed over medical stubbornness and yes, ignorance. Do you have heart trouble possibly leading to bypass? Check into chelation first. The info is all there on the Internet under **EDTA chelation**.

By the way, I wrote to VP-elect Dick Cheney about chelation, but doubt that what I wrote will get to him, or if it does, whether he'll take it seriously. Cheney had a heart attack at age 38 and he's had three heart attacks since. If anyone knows the VP (and I'm sure some subscriber does) tell him to call me. I'll give him the word, honest I will.

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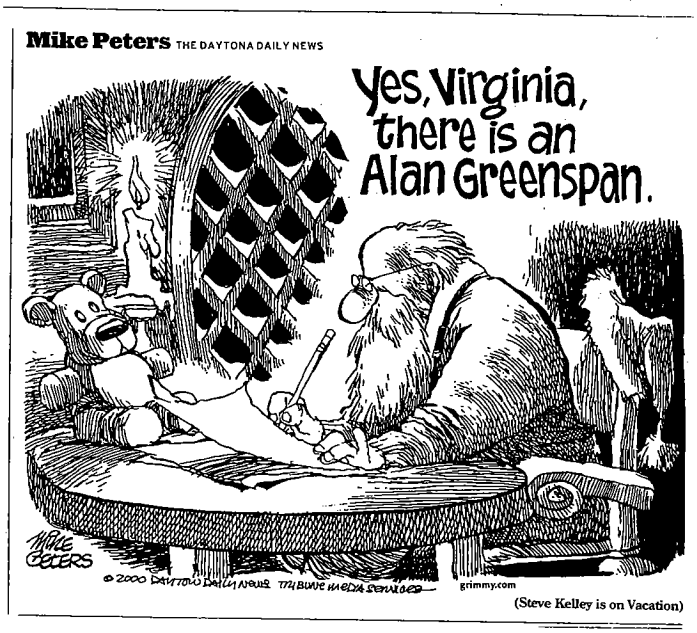
The faith in Alan Greenspan is amazing. This cartoon says it all. The cartoon is telling us that yes, Greenspan has become Santa Claus. Is this a fact, or is it rather sick? You make the call.



(Steve Kelley is on Vacation)

A LOT OF LATE NOTES: I believe the bear market is now moving into its second psychological phase. The second phase, usually the longest phase, is when stocks go down as they discount deteriorating conditions in business and the economy.

I think the speed of the downturn in the economy is going to surprise most people, including the Fed.

The downturn is clearly no surprise to the bond market. The investment-grade bonds have been surging ahead, hitting new highs almost daily. I said on my Internet site that my point & figure chart of the bellwether 10 year T-notes shows a projection or target yield of at least 5.1%.

At the rate the bonds are rising, it would seem that bond buyers (and they tend to be sophisticated) are totally ignoring any chance for inflation and are now concentrating on the odds of recession next year. Judging by the bond action so far, I'd have to conclude that bond buyers are positioning themselves for recession.

The best investments are usually where the public is not. Where the public IS is in stocks and stock mutual funds. Where the public is NOT is in bonds.

As the recession takes over, the big need for the average US family is going to be **INCOME**. Up to their necks in debt, US families are going to be frantic for income. With stocks in a bear market, with stocks offering literally nothing in the way of dividends, the public will slowly but surely see the value of interest-bearing high-grade bonds.

So write this down – income, income, income. This is going to be the operative word as we move on into recession.

And the safest and surest income is in bonds. Even better, tax-free income in high-grade municipal bonds.

I think the general opinion now is, "OK, the Nasdaq has taken a beating. It's been cut in half in a period of eight months. But those tech stocks were ridiculously over-priced and I guess they should have 'corrrected.' But the big stocks, the backbone of the economy stocks, the Dow stocks, they haven't done that badly. As long as the Dow holds above 10000, no problem. In fact, some of the blue chip stocks are beginning to look cheap."

I do think that's the attitude among most investors. And I have the feeling that what we've seen in the Dow is really the bear playing with our minds and with our pocketbooks.

As the bear market progresses, I believe attention will switch from the disaster in techs and the Nasdaq to the Dow and the blue chips.

The fact is that the Dow is still selling at 20 times earnings while yielding a paltry 1.6%. These are valuations that are characteristic of a bull market top, rather than anything even close to a bear market bottom.

If my interpretation of Dow Theory proves to be correct, we will see the bear fully express himself. This could mean a final low for the Dow with that Average selling at around ten times earnings while yielding about 6%.

I have no idea what series of events will cause the Dow to sink to a classic bear market bottom. But I do believe that the odds suggest a bear market bottom.

One thing bothers me, and I've talked about this before. The Fed will fight a downturn "tooth and nail." This Fed is intent on keeping the economy from sinking into recession. If the Fed fights the downturn, and I'm sure they will, then what they'll be doing is simply extending the bear market.

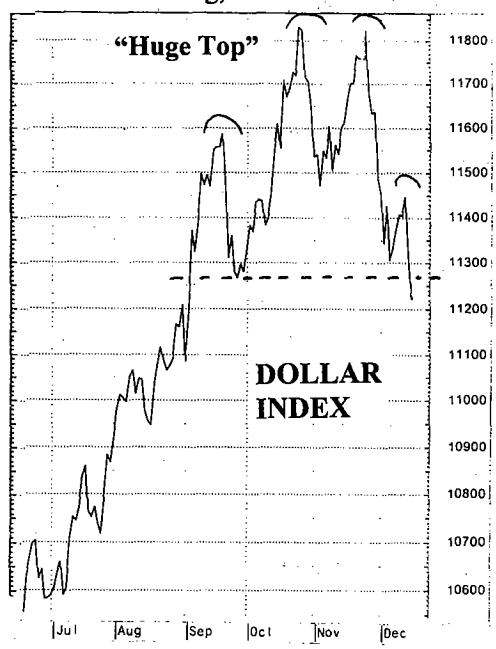
I go on the thesis that one way or another, this bear market will fully express itself. It may take another six months, it may take a year, it may take five years. There's absolutely no way of telling.

As I've said many times, it makes a lot more sense to IDENTIFY than to try to PREDICT. I've already **identified** that we're in a primary bear market. I would be foolish to try to **predict** how it will end and when it will end.

Question: Russell, I note that the bonds have been hitting new highs almost daily. I thought rising bonds exerted a very bullish force on stocks. Why isn't this working?

Answer: It works in a bull market but not necessarily in a bear market. The bonds and stocks are now (finally) going in separate directions, but they are both discounting the same thing – deteriorating business conditions. When business turns down people move into the safety and sure income of bonds – and out of sinking, dividend-less stocks.

NEXT MAILING: January 10, 2001



DOLLAR: I've been saying that the dollar is in the process of topping out, while at the same time the euro has formed a powerful bottom. If there's any doubt about the fading dollar, it was erased on December 15 as the March Dollar index broke below support in what is clearly a huge, well-defined top (I would not be surprised to see the euro selling at par with the dollar within a few months or less).

The chart above, covering the period from July to the present, shows the massive top in the Dollar Index and the breakdown through support which occurred on Dec. 15. The chart shows a "count" down to at least 109.

GOLD: I must say that the gold action is disappointing. Feb. gold is holding just above its 50-day moving average, which stands at 272.40 To impress me, Feb. gold would have to close above 278. Hasn't happened yet.

Last but certainly not least, Seasons Greetings and Best Wishes to all my subscribers.

And please, get a computer or a desk top email machine (now around $100) and get on the Internet. I put a lot of time and energy into my daily site reports, and honestly, I believe they are well worth reading.